

**Letter of Findings Numbers: 00-0286, 03-0167
Nonresident Withholding Tax
For Tax Periods: 1996-2001**

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ISSUES

I. Nonresident Withholding Tax—Addback of Income Taxes

Authority: IC § 6-3-1-3.5; *Aztar Indiana Gaming Corp. v. Indiana Dep't of State Revenue*, 806 N.E.2d 381 (Ind. Tax Ct. 2004).

Taxpayer protests the addback of riverboat wagering taxes in determining the partner's adjusted gross income for withholding tax purposes.

II. Nonresident Withholding Tax—Applicability

Authority: IC § 6-3-4-12.

Taxpayer protests the applicability of nonresident withholding tax when Taxpayer is owned by intervening pass-through entities.

III. Nonresident Withholding Tax—Computation

Authority: IC § 6-3-1-3.5; IC § 6-3-4-12.

Taxpayer argues that any losses incurred by it prior to adjustments be used to offset the adjustments for determining its ultimate withholding tax liability.

STATEMENT OF FACTS

Taxpayer was a limited liability company. Corporation A owned 85 percent of Taxpayer and LLC 1 owned the other fifteen percent. In turn, Corporation A and Corporation B owned LLC 1. One nonresident individual owned all the shares in both Corporation A and Corporation B. During the years in question, Taxpayer computed its withholding tax liability without adding back riverboat wagering taxes in calculating Taxpayer's income subject to withholding. The Department assessed withholding tax based on adding back the riverboat wagering tax paid by Taxpayer. Taxpayer protested the addback of riverboat wagering tax, the applicability of withholding liability to Taxpayer, and the computation of its liability. Additional facts will be supplied as necessary.

I. Nonresident Withholding Tax—Addback of Income Taxes

DISCUSSION

With respect to the validity of the assessment, the Indiana Tax Court has determined that the riverboat wagering tax is a tax "based on or measured by income and levied at the state level by any state of the United States." *Aztar Indiana Gaming Corp. v. Indiana Dep't of State Revenue*, 806 N.E.2d 381, 386 (Ind. Tax Ct. 2004). Accordingly, with respect to individuals, the tax must be added back per IC § 6-3-1-3.5(a)(2) in order to determine the individual's adjusted gross income—which is the basis for withholding tax liability.

FINDING

Taxpayer's protest is denied.

II. Nonresident Withholding Tax—Applicability

Taxpayer argues that its owners were business entities in good standing with the state of Indiana. IC § 6-3-4-12(a) states in relevant part:

Every partnership shall, at the time that the partnership pays or credits amounts to any of its nonresident partners on account of their distributive shares of partnership income, for a taxable year of the partnership, deduct and retain therefrom the amount prescribed in the withholding instructions referred to in section 8 [IC § 6-3-4-8] of this chapter.

In the instructions for Form IT-65 for the years in question, highlighted in a text box, is the following statement:

A partnership must withhold tax from income distributions to an S corporation, fiduciary or another partnership passing through Indiana income to a nonresident shareholder, beneficiary or partner and designate as a "Nominee" the ultimate recipient as if there were no other intermediary entities. The upper tier partnership passing through Indiana income to its partners must withhold tax for nonresident nominees on a final pro rata basis without reapportioning the income at the lower level. See Income Tax Information Bulletin #85.

Taxpayer is the upper tier partnership in Taxpayer's arrangement. Taxpayer had the duty to look past the intermediary entities to determine the ultimate owners as if those owners owned the partnership directly.

Then, Taxpayer had a duty to withhold income taxes on behalf of the ultimate owners if those owners were not Indiana residents. This duty applied regardless of whether any entity that owned the partnership was in good

standing with the State of Indiana. Once the ownership of the intermediary entities—Corporation A, Corporation B, and LLC 1—was determined, the *de facto* owner of the partnership was a nonresident individual. Taxpayer was responsible for withholding income taxes on behalf of the nonresident individual and designating the nonresident individual as a nominee. Notwithstanding Taxpayer's multiple layers of ownership, the primary responsibility for withholding income taxes rested with Taxpayer, and the assessment against Taxpayer was correct.

FINDING

Taxpayer's protest is denied.

III. Nonresident Withholding Tax—Computation

DISCUSSION

Taxpayer has also protested the amount of the assessment. Taxpayer's argument is that the losses at the withholding entity level (in this case, the top-tier limited liability company) must be considered in determining its withholding liability. An example of Taxpayer's argument—though presented by Taxpayer in a narrative form rather than a numerical form—is as follows: if Taxpayer incurred a \$10,000,000 loss, but had \$4,000,000 of taxes added back, then its liability would be based on a \$6,000,000 loss rather than \$4,000,000. If Taxpayer incurred a \$10,000,000 loss but had \$19,000,000 of taxes added back, its liability would be based on \$9,000,000 rather than \$19,000,000.

IC § 6-3-4-12 defines the responsibility for the withholding of taxes to amounts "that the partnership pays or credits amounts to any of its nonresident partners on account of their distributive shares of partnership income." Here, the partnership's net income for withholding tax purposes is the income prior to adding back taxes such as riverboat wagering taxes, along with various other adjustments required by IC § 6-3-1-3.5(a). Among the adjustments required under IC § 6-3-1-3.5(a) is the addition of the taxes paid by the partnership and deducted in arriving at the partner's adjusted gross income. The partner's adjusted gross income from the partnership is the end result of the calculations starting at the partner's adjusted gross income and otherwise modified in accordance with Indiana law. Accordingly, the partnership's liability for withholding is limited to its net income rather than the total amount of riverboat wagering tax added back, if the partnership had a loss prior to the taxes added back, as illustrated in the example above.

However, if Taxpayer had a profit or zero income prior to the addback, then the full amount of taxes added back are subject to withholding obligations. For instance, if Taxpayer had an income of \$5,000,000 prior to addback and added back \$10,000,000 of taxes, then the assessment on the \$10,000,000 of tax added back is proper because the difference in tax is between \$15,000,000 of income and the \$5,000,000 previously reported.

FINDING

Taxpayer's protest is sustained subject to audit review of the amount of net income.

Posted: 03/28/2007 by Legislative Services Agency
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